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THE SPECTERS OF STAGFLATION

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Growth forecasts are gloomy for the global economy. The Ifo Institute lowered its forecast for the FRG for this year from 3.3 to 2.5 per cent, while the International Monetary Fund (IMF) has lowered the growth for the gross national product (GDP) of the USA to six per cent. For China, whose real estate industry remains in acute crisis, growth is forecast at 8 per cent.

Adam Tooze writes: "In the last 18 months we have seen the fastest global growth in 50 years,

followed by the most rapid slowdown, creating what is in the BIS's view, a global economic configuration unprecedented in history.

Specifically, we have never seen such a combination of already rapid inflation and rapidly slowing growth with elevated financial vulnerabilities, notably high indebtedness against a backdrop of surging house prices...

So Putin's war is stoking inflation, but so far at least, it is not the main driver.

Furthermore, though inflation is widespread it is not general to the world economy. China and Japan, which dominate the East Asian economic region, have seen a very modest inflation.

Inflation in Europe has been far more rapid. But as of April 2022 more than two-thirds of inflation came from food and energy. This makes for an interesting contrast with the Americas – both in the United States and Latin America – where inflation is fast and involves all areas of the economy, including services (which are by far the largest part)."

And these are weak growth forecasts despite the massive decline in world production due to the Corona crisis and massive financial subsidies by Western states and their central banks into the economies, with subsidised sums by the state in the USA alone amounting to ten times the sum spent after the financial crisis of 2008. However, the effects of this kind of state intervention touted by the Keynesians have largely failed to materialise, and the effects of the state's economic stimulus measures are becoming increasingly weak.

This weak growth is accompanied by rather unexpected inflation in industry. We saw steadily rising asset price inflation in the years after the financial crisis, but this is now spilling over into the industrial sector. Already in October last year, the inflation rate in the FRG was 4.5 per cent, while in the US at the same time the inflation rate was 6.2 per cent. In the USA, this was the highest value in 30 years. The spectre of stagflation, the mix of stagnation and inflation, is looming, reminiscent of the oil price shock of 1973, when OPEC cut production in response to wars. Today, we are dealing with supply bottlenecks in global supply chains and a price increase in many intermediate products, raw materials and fossil fuels. This price increase, including the supply bottlenecks, results on the one hand from the Corona crisis, and on the other hand from the overloading of a partially defective and neoliberally privatised infrastructure in many capitalist core countries.

Some authors now speak of supply inflation, in which prices are driven up by costs. Inflation has risen precisely because commodity prices have risen. Increased commodity prices are passed on to the goods produced from them, whose prices then also rise. But why have commodity prices risen? In general, the costs of producing raw materials have not risen, because productivity increases in the extraction of raw materials have often even lowered them. And material costs are also determined on the basis of the prices that are expected, precisely in order to realise high profits. So at the moment it is mainly temporary problems in the supply chains that lead to price increases. In fact, it is the supply side rather than demand that is driving inflation.

For Marxists, prices in a capitalist economy are determined by the supply of value contained in

its production and the supply of non-commodity money. Price inflation is thus supply-driven. , The collapse of the COVID pandemic was clearly a “supply shock”. Production collapsed with closures, workers were sent home or to hospital, transport and trade ground to a halt; social activities and events were replaced by isolation. The pent-up demand then was the result of the previous supply shock, and the price rise only accelerated because the pent-up supply did not follow suit. The “shock” on the supply side is a continuation of the slowdown in industrial production, international trade, business investment and real GDP growth that had already occurred in 2019 before the pandemic broke out. This occurred because the profitability of capitalist investment in the major economies had fallen to near historic lows.

Higher material and/or labour costs are supposed to push up prices, but it must never be forgotten that companies raise prices because they want to increase their profits. However, this is only possible for companies with a high degree of market power. Inflation is the average rate of change of individual money prices. Only in this narrow sense, Milton Friedman’s assertion that inflation is a monetary phenomenon is correct. However, as Bichler/Nitzan have shown, the average rate of inflation masks individual price changes at different rates. And in this sense, inflation is always and everywhere a redistribution phenomenon also within firms. This means that wholesale price inflation has tended to lead to a systematic redistribution of profits from smaller to larger firms.

This price increase is accompanied by a rising demand for commodities such as sand, which is needed for the rise of the real estate industry in many countries, first and foremost China. Debt-financed and commodity- and energy-intensive real estate construction is the driving engine of China’s economy. At the same time, demand for both fossil raw materials and those needed for the green transformation is increasing, and supply shortages are also emerging. Brazil is currently having to import more fossil fuels as a drought increasingly puts the country’s hydropower plants out of action.

Some authors are now talking about demand inflation. But the current price increases for many products, especially energy, electricity, petrol and food, have nothing to do with the fact that demand for the products has increased. Demand cannot have increased for low incomes, since they cannot demand more goods for lack of money. Here consumers who are robbed of real income by higher prices are falsely blamed for rising prices.

It seems that even the Fed now no longer sees the rise in inflation as temporary, but that it is likely to continue for some time, even though its median forecast is for personal consumption inflation to be 5.3% in 2021, but then to fall to 2.6% in 2022 and finally to 2.1% by 2024.

The reason for the “unexpected” nature of inflation, according to the Fed, is the extraordinary circumstances of the pandemic. A normal rise in inflation, the conventional theory goes, would be a result of too much money being injected into the banking system or the result of “tight” labour markets (i.e. low unemployment) and strong consumer demand as the economy expands. That’s the case, says the Fed, but there’s also the pandemic factor: “These problems have been larger and longer than expected and have been exacerbated by the viral waves.”

The pandemic has exacerbated inflation because 1) consumer demand has been pent up as people use up the savings they had accumulated during the pandemic, and 2) supply “bottlenecks” have arisen in trying to meet this demand – these bottlenecks have been caused by restrictions on the international movement of goods and components and continuing supply constraints – because much of the world is still suffering from the pandemic.

This names symptoms, but not causes.

For Marx, there was long-term deflationary pressure on the prices of commodities due to rising labour productivity, which lowers prices per unit. However, for Marx there were countervailing factors that could exert upward pressure on prices in the long run, for example the intervention of monetary authorities with their attempts to control the supply of money. Carchedì's theory of inflation assumes a rate of inflation in value terms, combining the effects of changes in the purchasing power of wages and profits (new value) and the money supply, measured as cash deposits in banks (M2). The first factor is decisive and tends to cause price inflation to fall, while the second factor counteracts this and tends to cause inflation to rise, but without lasting effect. If Carchedì's theory is correct, then the return of inflation to Corona depends on the forecasts for new value and M2 money supply growth, and thus on the forecast for the value-based inflation rate.

Moreover, there has never been inflation caused by rising wages. In fact, over the past 20 years up to 2020, real wages grew by an average of only 0.4% per year, less than the average annual real GDP growth of around 2%. It is the share of GDP growth that goes to profits that has increased. Marx argued that rising wages do not lead to price rises, but to falling profits, and this is the real reason why mainstream economics brings wage-driven inflation into play.

If there is going to be a rise in costs this year, it will come from companies raising their prices as the cost of raw materials, goods and other inputs rises, partly due to Corona's disruption of the supply chain. The FT reports that “Price increases have become a dominant theme in the quarterly earnings season that began this month in the US. Executives at Coca-Cola, Chipotle and appliance maker Whirlpool, as well as household brand giants Procter & Gamble and Kimberly-Clark, told analysts at earnings calls last week that they were preparing to raise prices to offset rising input costs, particularly for raw materials.”

For Michael Roberts, output price inflation ultimately depends on what happens to the creation of new value in an economy in the future – and that depends on the rate of capital accumulation and the profitability of that capital. Inflation rates reached post-war lows in the 2010s despite “quantitative easing” because real GDP growth slowed along with investment and productivity growth. Monetary policy has only weakly countered this downward pressure on price inflation.

On the other hand, the use of speculative capital since the 1980s has fuelled a boom in derivatives, equity and bond markets, with financial and real estate markets also benefiting from the low cost of credit and the amount of money pumped into the markets by central banks. These markets experienced high inflation. While the velocity of money (the turnover of transactions in the “real” economy) fell, reducing the impact of money injections on productive

investment and the prices of goods and services, the prices of derivatives, financial assets and assets such as real estate skyrocketed.

Followers of Monetarism today (Tim Congdon) say that while various factors are important in the current inflation story (including lockdowns, substitutions effects between goods and services, commodity price shocks in part due to wars, absenteeism due to Long COVID, and so on), that the dominant factor driving inflation is the massive surge in money growth brought about by the 'helicopter money' policies employed by the West ... Today's central bank targeting of the headline CPI growth rate, while not pure monetarism, does achieve its goals by (indirectly) controlling money supply growth. As such, it's a stronger institutional framework for controlling inflation than that of the 1970s, with the implication that a **repeat of the wage price spiral of the 70s is much less likely**.

As Adam Tooze and Joscha Wullweber show in their new books, the functions of central banks in 2020 were strengthened by their new role as market makers. As Daniela Gabor writes in an essay, "Indeed, central banks have quietly added a fourth dimension to the holy trinity of inflation targeting – price stability as the primary central bank objective, central bank independence as the institutional arrangement, and the short-term interest rate as the operational objective: large-scale intervention in government bond (or monetary financing) markets. These purchases aim to facilitate private financing by supporting the liquidity of government bond markets (prudential or market-maker-of-last-resort function) and lowering yields through QE (a macroeconomically motivated intervention)."

When financial markets around the world collapsed on 9 March 2020, the US Federal Reserve (Fed) reacted immediately and with concentrated force. It launched a historic emergency programme, providing \$2.3 trillion in loans to support the economy. The Bank of England, the Bank of Japan, the Swiss National Bank and the Bank of China launched similar programmes. And while all other European institutions were paralysed or simply had no effective means, the European Central Bank (ECB) also stepped in with all its might. In an unprecedented move, it launched a pandemic emergency purchase programme of 750 billion euros in mid-March 2020, which was later increased to 1,850 billion euros. These funds were used primarily to buy government bonds of member states. In addition, the asset purchase programme was expanded immensely, to 140 billion euros per month.

Unlike the fiscal policy of governments, which can directly support businesses and consumers, the monetary policy of central banks does not directly reach the real economy. It has to take a diversion via the financial system, for example by buying securities. But this means that these measures do not currently reach the real economy. Instead, the money is used by the financial actors primarily for investments within the financial system. The support of repo transactions by central banks directly promotes the shadow banking system.

Central banks no longer perform the function of a "lender of last resort" unchallenged, since a high proportion of national and transnational operations of financial capital (commercial, investment and shadow banking) are carried out independently of the central bank, while on the

other hand the state intervention power of central banks always remains dependent on the price movements of derivative monetary capital. However, it is precisely in times of economic crisis that the use of the hedging instrument “central bank” is then resorted to by the endangered financial capital units themselves. Central banks constantly link their operations such as minimum reserves, liquidity protection and interest rate policy with the strategies of private finance capital. In the course of the policy of “quantitative easing” (QE), the withdrawal of central bank interest rates in particular has strongly promoted and accelerated expansive developments on the money markets, without the investment dynamics of industrial capital having improved markedly so far. At present, short-term interest rate changes due to QE policy no longer have any cyclical influence, since companies tend to reduce debt in recessions rather than take it on, so that the key interest rate also loses its control and allocation function for (industrial) capital accumulation, at least gradually.

Today, a globally circulating capital has emerged that is constantly in search of reasonably safe profits. “Safe profits” means that risk management (the probability of making an expected profit) acquires a fundamental importance in the financial markets. In this context, the functioning of the financial system involves not only the capitalisation of speculative investments, but also the components of a control mechanism that “regulates” and, where possible, promotes the respective mobility of individual capitals by constantly recreating the conditions for competition. By exposing individual capitals to national and international competition and financing their activities, one simultaneously creates methods to reward profitable capital and punish unprofitable capital.

At the onset of the Covid 19 crisis in 2020, there was a sharp decline in the supply and demand of industrial production worldwide. In addition to huge profits from Big Pharma, the big tech platforms and some big banks, total corporate profits in the US fell by about 30% in 2020. Global action to contain the Covid 19 pandemic also triggered another crisis in the global financial system. As disagreement over the economic impact of Covid-19 grew from February 2020, stock indices fell precipitously. Investors began to buy enormous amounts of US government bonds in particular. Their yields fell and their prices rose, while asset prices in risky financial markets plummeted as financial players tried to raise funds by selling securities. However, since hardly anyone wanted to buy these securities at the time, prices plummeted. The flight into cash did not stop while assets were liquidated. The run on the US dollar increased activity in the currency markets, while safe assets were now also sold on and algorithmic trading was reduced. Even safe government bonds ended up being sold to raise cash. Volatility in the markets was extremely high.

Already in the years before Covid-19, central banks intervened massively in the shadow banking system and acted as dealers, conducting repo transactions for banks of all kinds. They no longer served merely as liquidity providers, but became traders in the financial markets. When the Covid 19 financial crisis broke out, central banks again worked more with traditional measures such as lowering policy rates and providing liquidity, but also used massive measures such as quantitative easing and repo actions and acted as traders in the markets and organised currency

swaps. In addition, loans were made to non-financial actors. The Bank of England bought British government bonds directly on the primary market. The central banks thus decided to provide substantial funds, while the governments launched additional investment programmes with enormous sums.

Despite the collapse of the global economy with the Covid 19 crisis, asset prices started to rise again after the short fall in 2020. In search of higher returns, financial investors turned again to risky financial products and junk bonds, while stock market indices rose to record highs. To achieve higher returns, many institutional funds again invested in highly leveraged and less liquid assets. The money pumped into the markets by central banks financed financial asset price growth much more than consumption and investment. Currently, Joe Biden is planning a huge investment package for the US. But government investment as a share of GDP is about 3% of GDP in developed economies, while private capital investment averages about 20% of GDP. So a revival of investment depends more on capitalist investment. Economists believe that the “multiplier effect” of government spending on real GDP growth is no more than 1 percentage point.

At the moment, the policy of cheap money is further fuelling the asset and credit crisis, as debt ratios are already high. For example, we already see high price-to-earnings ratios, inflated property values and high-yield corporate debt. We could also see a new consumer price inflation that sets the stage for a kind of stagflation, while at the same time we can expect problems in the supply sector from protectionism, further immigration restrictions and disruptions in global supply chains.

If inflation rises in the next few years, central banks may have to raise policy rates and then risk a massive debt crisis. However, if they maintain a policy of cheap money, stagflation could occur while problems in the supply sector persist. But even if they maintain the second strategy, a debt crisis could follow, as private debt in advanced economies could become unsustainable and their yield spreads over government bonds could rise. Highly indebted companies would go bankrupt, followed by indebted households and part of the shadow banking and private banking system.

So the Fed is in a dilemma. If it tightens monetary policy too much and raises interest rates “too fast”, it could cause the cost of borrowing for investment or spending to rise so much that new investment in technology declines, consumer demand for products stalls and there is an economic slump. This is especially true given the record levels of corporate debt. However, if the central bank does not act to reduce and stop its monetary injections and raise interest rates, then high inflation may not be temporary at all.

Adam Tooze writes: One obvious concern is that a sudden tightening in interest rates may produce a wave of bankruptcies amongst stressed debtors unleashing havoc in the banking system – the 2007-8 scenario. According to the BIS, in a “2004 tightening” scenario, bank credit losses might rise to the level seen after 2008... One important channel is the debt service ratio – the share of private income that goes to pay interest owed on debts. In recent years, corporate

finances and real estate markets have been fueled by historically low rates. Until the summer of 2021 the expectation was that those would persist for the foreseeable future. Now, markets are pricing in a significant rate rise. In agreement with central bankers they project rates rising to c. 3 percent over coming years. That has been enough to trigger a market sell off and significant symptoms of a slowdown in manufacturing and employment in the United States. The BIS, however, has long been suspicious of the complicity between complacent markets and compliant central bankers.

The result is that the Fed is looking for a middle ground. The same is true for the Bank of England and the European Central Bank.

Edelmüller writes:

“The pricing on the spot markets for fossil energy commodities and their derivatives, which play an important role in the supply of fuels and thermal energy sources, is not so much influenced by real shortages with actual supply bottlenecks, but by the speculative expectation of possible shortages in the near future, which is reflected in the pricing of relevant futures contracts on the financial markets.

The energy price explosion, which has clearly dominated the general inflation shock for more than a year, alongside the pandemic-related supply chain disruptions, is recognisably driven by the economic war and its troop of speculators and profiteers. Inflation is therefore to a large extent a speculative and profit-driven inflation that starts on the futures trading markets for energy commodities and finds its continuation in the real price enforcement power of the energy companies. The exploding profits are paid for by the mass of consumers in the inflation-threatened end-user markets, where the working population suffers real income losses from wages and monetary transfers, so that poverty and the risk of poverty continue to spread.”

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